

STATE OF CALIFORNIA

Public Utilities Commission
San Francisco

M e m o r a n d u m

Date: June 8, 2004

To: The Commission
(Meeting of June 9, 2004)

From: Alan LoFaso, Director
Office of Governmental Affairs (OGA) — Sacramento

Subject: **AB 2303 (Leno) Public utilities: corporate taxation: insolvency**
As Amended April 21, 2004

Legislative Subcommittee Recommendation: Oppose.

Summary: This bill would bar rate recovery for bonuses for executive officers of an insolvent utility.

Digest: Existing law, P.U. Code sec. 451, requires that all charges demanded or received by any public utility for a product or commodity be just and reasonable.

This bill would require that any expense resulting from a bonus paid to an executive officer of an insolvent utility be borne by the shareholders of the utility and would prohibit any expense resulting from the payment of a bonus by an insolvent utility from being recovered in rates. This bill would define “executive officer” as persons who perform policymaking functions such as the president, secretary, treasurer, or specified vice presidents.

Analysis: This bill was introduced by the author in response to Pacific, Gas and Electric Company’s (PG&E’s) award of over \$80 million in retention bonuses to its 17 topmost executives at the end of 2003.

The Commission recently examined issues related to PG&E’s executive compensation in Decision (D.) 04-05-055. The Commission reviewed and commented on certain executive bonuses designed to promote the retention of certain corporate officers during the difficult period of the energy crisis and the financial insolvency and bankruptcy of PG&E and PG&E Corp.’s non-utility affiliates.

In January 2004, PG&E Corporation awarded \$84.5 million in retention bonuses to 17 executives pursuant to a Senior Executive Retention Program (SrERP). These

bonuses vested only days after PG&E Corporation (the holding company), PG&E (the utility) and the Commission entered into a Modified Settlement Agreement (MSA) regarding PG&E's emergence from bankruptcy. The size and timing of these bonuses raised concerns regarding ratepayer impact and public policy.

In D. 04-05-55, the Commission found that none of the \$84.5 million has been, or will be, charged to ratepayers. The Commission adopted additional accounting and reporting measures to further ensure that the \$84.5 million is charged to shareholders, not ratepayers. The Commissioners were appalled at the size of the award, and encouraged the senior executives to voluntarily return any amounts not needed to meet the program's purpose, or that are unreasonable or inequitable. The matter is now in the hands of the 17 senior executives, PG&E's shareholders and the California Legislature.¹

The underlying policy goal associated with AB 2303 is well intentioned. Moreover, in the narrow scenario in which this bill would apply (an insolvent utility), the Commission has taken appropriate action to ensure that ratepayers are not responsible for these costs. Therefore, bill is unnecessary.

Moreover, the bill still contains ambiguities, and to the extent that its provisions remain unclear, it could have unintended consequences. The current version is less of a concern than prior versions of the bill, which encompassed not only officers but essentially every employee of the utility. The current version now only applies to officers, defined as employees with policymaking functions, such as president, secretary, or certain vice-presidents.

Generally, the Commission has retained the authority to analyze, on a case-by-case basis, whether or not various types of bonuses warranted funding by ratepayers. Depending on the particular circumstances of the case, the Commission has at times allowed utilities to use their discretion in allocating compensation between base salary and incentives. At other times, the Commission has decided that ratepayers and shareholders should share the cost of incentives. Most recently, the Commission has tentatively decided that as long as incentives were included in the Total Compensation Studies, and such studies indicated that compensation was at market levels, then the incentives would be allowed into rates.

Even with the limited application of the current version of the bill, Legal Division has expressed concerns that the measure's implementation may be complex and time-consuming because a utility may be intermittently insolvent and bonus expenses may have been approved prospectively and recovered in rates prior to the time of insolvency. Further, certain terms in the bill are undefined and could cause ambiguities in application.

¹ The Commission took notice of AB 2303 in this part of the decision.

“Bonus” is not defined, and utilities could attempt to classify all compensation as salary to avoid application of the statute. Every form of incentive pay and/or rewards program could fall under the term of “bonus”. Some incentive payment programs allowed in rates today are awarded to employees to encourage performance and the Commission has found that ratepayer funding should be allowed because ratepayers benefit from these particular incentive programs.

The bill also provides that a bonus paid by an insolvent utility cannot be recovered in rates. If a bonus is paid when the utility regains solvency, may the bonus be recovered in rates even though the utility was insolvent for part of the year for which the bonus was paid? For example, if a utility is insolvent for ten months of the calendar year, but not in December, and a bonus is paid in December for performance during the calendar year, is the bonus recoverable in rates? What if the utility was insolvent for only one month during the calendar year?

To the extent bonus expenses previously were approved and recovered through rates, the bill is also ambiguous as to whether it would authorize retroactive ratemaking, which could cause confusion and potential challenges. Section 734 of the Public Utilities Code prevents retroactive ratemaking. This prohibition may be overridden by another statute. Accordingly, the bill might be amended to provide that such bonuses shall not be allowed as an expense in any rate case and that if such bonus expenses have previously been recovered in rates, an equivalent amount should be deducted from the utility’s revenue requirement in the future.

Generally, statutes generally are effective prospectively only and presumably this bill will not apply to any bonus paid before January 1, 2005. It is not known whether this bill is intended to have retroactive effect. Although, if that were the intent, the Commission has already taken action to appropriately address the circumstance to which this bill is directed.

Elizabeth McQuillan of the Commission’s Legal Division and Laura Martin of the Commission’s Energy Division contributed significantly to this analysis.

LEGISLATIVE HISTORY

Assembly Floor: 55-22 (pass) (5/17/04)

Assembly Appropriations: 16-5 (do pass) (5/5/04)

Assembly Revenue & Taxation 6-0 (do pass as amended) (4/19/04)

Assembly Utilities & Commerce 7-4 (do pass as amended) (4/12/04)

SUPPORT/OPPOSITION

Support: Greenling Institute, The Engineers and Scientists of California, The Utility Reform Network (TURN)

Opposition: None on file.

LEGISLATIVE STAFF CONTACT

Alan LoFaso, Legislative Director
CPUC-OGA

alo@cpuc.ca.gov
(916) 327-7788

Date: June 8, 2004

BILL LANGUAGE:

BILL NUMBER: AB 2303 AMENDED
BILL TEXT

AMENDED IN ASSEMBLY APRIL 21, 2004
AMENDED IN ASSEMBLY APRIL 15, 2004

INTRODUCED BY Assembly Member Leno

FEBRUARY 19, 2004

An act to add Section 451.5 to the Public Utilities Code,
~~and to add Section 24428 to the Revenue and Taxation Code,~~
relating to public utilities.

LEGISLATIVE COUNSEL'S DIGEST

AB 2303, as amended, Leno. Public utilities: corporate taxation: insolvency.

(1) Under existing law, the Public Utilities Commission has regulatory authority over public utilities, and authorizes the commission to fix just and reasonable rates and charges.

This bill would require that any expense resulting from a bonus paid to an executive officer, as defined, of an insolvent utility be borne by the shareholders of the utility and would prohibit any expense resulting from the payment of a bonus by an insolvent utility from being recovered in rates.

~~(2) The Bank and Corporation Tax Law allows various deductions in computing income subject to taxation. Among other things, that law allows a deduction for the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including compensation paid to officers and employees.~~

~~This bill would provide that no deduction shall be allowed for the costs paid or incurred during the taxable year by a public utility for any bonus paid to an executive officer during the period that the utility is insolvent, as defined.~~

~~This bill would result in a change in state taxes for the purpose of increasing state revenues within the meaning of Section 3 of Article XIII A of the California Constitution, and thus would require for passage the approval of 2/3 of the membership of each house of the Legislature.~~

~~(3) Under existing law, a violation of the Public Utilities Act or an order of the commission is a crime.~~

Because certain provisions of this bill would be a part of the act and a violation of those provisions would be a crime, this bill would impose a state-mandated local program by creating a new crime.

~~(4)~~

(3) The California Constitution requires the state to reimburse local agencies and school districts for certain costs mandated by the state. Statutory provisions establish procedures for making that reimbursement.

This bill would provide that no reimbursement is required by this act for a specified reason.

Vote: ~~2/3~~ majority .
Appropriation: no. Fiscal committee: yes. State-mandated local
program: yes.

THE PEOPLE OF THE STATE OF CALIFORNIA DO ENACT AS FOLLOWS:

SECTION 1. Section 451.5 is added to the Public Utilities Code, to read:

451.5. (a) Any expense resulting from a bonus paid to an executive officer of an insolvent utility shall be borne by the shareholders of the utility. No expense resulting from the payment of a bonus by an insolvent utility may be recovered in rates. For purposes of this section, "insolvent" means the utility has ceased to pay its debts in the ordinary course of business, the utility cannot pay its debts as they become due, or the utility's liabilities exceed the utility's assets.

(b) The requirements of subdivision (a) do not apply to any bonus that is part of a standard employee compensation contract.

(c) For purposes of this section, "executive officer" means any person who performs policy making functions and is employed by the utility, and includes the president, secretary, treasurer, and any vice president in charge of a principal business unit, division, or function of the utility.

~~SEC. 2. Section 24428 is added to the Revenue and Taxation Code, to read:~~

~~24428. (a) Notwithstanding any other provision in this part to the contrary, no deduction shall be allowed for the costs paid or incurred during the taxable year by a public utility for any bonus paid to an executive officer during the period that the utility is insolvent.~~

~~(b) The requirements of subdivision (a) do not apply to any bonus that is part of a standard employee compensation contract.~~

~~(c) For purposes of this section:~~

~~(1) "Executive officer" means any person who performs policy making functions and is employed by the utility, and includes the president, secretary, treasurer, and any vice president in charge of a principal business unit, division, or function of the utility.~~

~~(2) "Insolvent" means the public utility has ceased to pay its debts in the ordinary course of business, the public utility cannot pay its debts as they become due, or the public utility's liabilities exceed its assets.~~

~~SEC. 3.~~

SEC. 2. No reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution because the only costs that may be incurred by a local agency or school district will be incurred because this act creates a new crime or infraction, eliminates a crime or infraction, or changes the penalty for a crime or infraction, within the meaning of Section 17556 of the Government Code, or changes the definition of a crime within the meaning of Section 6 of Article XIII B of the California Constitution.